Flexible Spending Account for Dependent Care

Information for Employees

What: A Flexible Spending Account (also called a Dependent Care Assistance Plan (DCAP) or Reimbursement Account) is an individual pre-tax benefits account run through your employer. An employee decides how much to set aside each year for childcare. The employer decreases the employee's income by that set amount and places the money in the account. The employee then withdraws that money by submitting receipts for child care services.

Who Can Use It: Anyone is eligible to use a Flexible Spending Account (FSA), as long as their employer offers it.

Details:

Benefits:

- Money in the account is free from Medicare tax, Social Security tax, and federal and state income taxes. Tax savings on $5,000 placed in an account would be between $1,100 and $2,600. That means more of your money is available for dependent care.
- Savings can be more substantial than a Child and Dependent Care Tax Credit for middle income families. Lower income families may become eligible for the Earned Income Tax Credit (*see reverse) because participation in a Flexible Spending Account program lowers taxable income. Unlike the tax credit, families with one parent not working can use a FSA.

Drawbacks:

- There is a limit of $5,000 (even if a family spends more than $5,000 on childcare).
- Funds not claimed for reimbursement revert back to the employer, so families need to be able to project their childcare costs for the coming year. However, even if families don't spend the full amount, the tax savings are generally worth the risk.
- You must pay for the care and then be reimbursed later. You must provide amount paid and tax IDs for each provider.
- Families may only sign up for Flexible Spending Accounts at benefits enrollment time, when they begin working at a new job, or when a child is born.
- Families may only change their account if there is a qualifying event, such as birth of a child, lost job, or significant increase in child care costs.
- Money placed in an account counts toward the $3,000 and $6,000 limits associated with the Child and Dependent Care Tax Credits without being eligible for the credit, so you should decide whether a Flexible Spending Account or a tax credit is better for you.

The Bottom Line: Any money you place in the account is not taxed. This can result in substantial savings.

How you save with a FSA	**Tax Rate**	
	Minimum	**Maximum**
Federal Income	10%	37.5%
State Income	5%	7%
Social Security	6.2%	6.2%
Medicare	1.45%	1.45%
Total	22.65%	52.15%
Savings with $5,000 FSA	**$1,133**	**$2,608**

Compare this to the maximum possible child care tax credit benefit for two children. At the minimum tax rate, your credit would be $3,024. At the maximum tax rate, your credit would be $1,152. Thus, Flexible Spending Accounts provide the most savings for middle and upper income families.

Next Steps: Contact your employer to see if a Flexible Spending Account is available to you.

See other side of this sheet for two example families!

Example Family 1: Anna Chen is a single mom with an adjusted gross income of $30,000 a year. She has two children, both of whom are under 13 years old, and she spends $4,000 a year on childcare. She files her taxes as head of household. She puts $3,000 in a Flexible Spending Account through her employer. The worksheet below shows how she can save $1,638 in taxes, including an increased Earned Income Tax Credit (EITC)*.

	Without DCAP		**With $3,000 DCAP**		
	Federal	**NY State**	**Federal**	**NY State**	**Savings**
Adjusted Gross Income	$30,000	$30,000	$27,000	$27,000	
Standard Deduction	-$6,650	-$10,500	-$6,650	-$10,500	
Exemptions Deduction	-$8,700	-$2,000	-$8,700	-$2,000	
Taxable Income	$14,650	$17,500	$11,650	$14,500	
Tax Liability					
Income Tax (w/o EITC)	$2,201	$756	$1,751	$599	**$607**
Social Security	$1,860		$1,674		**$186**
Medicare	$435		$392		**$43**
EITC	-$431	-$108	-$1,073	-$268	**$802**
Total Tax Liability	$4,065	$648	$2,744	$331	
Total Tax Savings					**$1,638**

Example Family 2: Jakisa and Rodney Roberts are married and have a combined adjusted gross income of $50,000. They have two children, both of whom are under 13 years old, and they spend $5,500 a year on childcare. They decide to file jointly. They put $5,000 in a Flexible Spending Account through Jakisa's employer. The worksheet below shows how they can save $1,427 in taxes.

	Without Flex. Acct.		**With $5,000 Flex. Acct.**		
	Federal	**NY State**	**Federal**	**NY State**	**Savings**
Adjusted Gross Income	$50,000	$50,000	$45,000	$45,000	
Standard Deduction	-$7,600	-$13,400	-$7,600	-$13,400	
Exemptions Deduction	-$11,600	-$2,000	-$11,600	-$2,000	
Taxable Income	$30,800	$34,600	$25,800	$29,600	
Tax Liability					
Income Tax	$4,624	$1,629	$3,874	$1,334	**$1,045**
Social Security	$3,100		$2,790		**$310**
Medicare	$725		$653		**$72**
Total Tax Liability	$8,449	$1,629	$7,317	$1,334	
Total Tax Savings					**$1,427**

* The EITC is a federal and state tax credit for lower income families. For more information visit http://www.irs.gov and http://www.tax.state.ny.us, or see your tax advisor.